No. ____

Supreme Court, U.S.
FILED
JUN 26 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1989

STATE OF NORTH CAROLINA and THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY,
Petitioners

V.

THE UNITED STATES OF AMERICA; LAURO F. CAVAZOS, SECRETARY OF THE UNITED STATES DEPARTMENT OF EDUCATION and THE UNITED STATES DEPARTMENT OF EDUCATION,
Respondents

Petition For Writ of Certiorari To The United States Court of Appeals For The Fourth Circuit

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QUESTIONS PRESENTED

1. Do the petitioners have a property interest subject to protection under the takings clause of the fifth amendment in the money which North Carolina Education Assistance Authority keeps on deposit in its Reserve Trust Fund to meet its insurance obligations to private lenders who hold defaulted student loans?

2. Do the petitioners have vested contract rights subject to protection under the takings clause of the fifth amendment in reimbursement payments owed to them on defaulted student loans pursuant to a reinsurance contract between the North Carolina Education Assistance Authority and the Secretary of Education which requires the Secretary to make such payments and § 428(c)(1)(A) of the Higher Education Act of 1965 which, prior to amendments at issue, specifically provided that the North Carolina Education Assistance Authority would "be deemed to have a contractual right against the United States, during the life of [any student loans the petitioners insured], to receive reimbursement" for losses resulting from the defaults on insured loans?

PARTIES TO PROCEEDING IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The parties to the proceedings in the United States Court of Appeals for the Fourth Circuit were the State of North Carolina, the North Carolina Education Assistance Authority, the South Carolina Education Assistance Authority, the Maryland Higher Education Loan Corporation, the United States of America, Lauro F. Cavazos, Secretary of the United States Department of Education and the United States Department of Education. The National Council for Higher Education Loan Programs, Inc. and the Virginia State Higher Education Assistance Authority participated as amici curiae.

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V.

THE UNITED STATES OF AMERICA; LAURO F. CAVAZOS, SECRETARY OF THE UNITED STATES DEPARTMENT OF EDUCATION; and THE UNITED STATES DEPARTMENT OF EDUCATION,
Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

Petitioners, The State of North Carolina and the North Carolina State Education Assistance Authority, petition for a writ of certiorari to review the opinion and judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-entitled proceeding on March 7, 1989.

OPINIONS DELIVERED IN THE CASE

The opinion of the United States Court of Appeals for the Fourth Circuit in this case is reported at 897 F.2d 1272 (4th Cir. 1990) and is reprinted in the Appendix (App.) to this petition. (App. 1A-

12A). The Order and Memorandum Opinion of the United States District Court for the Eastern District of North Carolina filed on July 20, 1989, is not reported but is reprinted in the Appendix. (App. 15A-22A).

JURISDICTION

The Fourth Circuit Court of Appeals entered its judgment in this case on March 7, 1990. (App. 4A). On March 28, 1990, the Fourth Circuit Court of Appeals denied the State of North Carolina's and the North Carolina State Education Assistance Authority's petition for rehearing and suggestion for rehearing in banc. (App. 25A). The petitioners believe that 28 U.S.C. § 1254(1) (1988) confers jurisdiction on the Court to review the March 7, 1990, judgment of the Fourth Circuit Court of Appeals.

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED IN THE CASE

1. The Takings Clause of the Fifth Amendment to the United States Constitution: "[P]rivate property [shall not] be taken for public use without just compensation."

2. Sections 3001 and 3002 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (1987). (App. 26A-31A).

3. Section 428(c)(1)(A) of the Higher Education Act of 1965, Pub. L. 89-329, 79 Stat. 1219 as amended [20 U.S.C. 1078(c)(1)(A) (1988)]. (App. 32A).

4. Section 682.400(a) of Title 34 of the Code of Federal Regulations: "The Secretary enters into agreements with a guarantee agency whose loan guarantee program meets the requirements of this subpart. The agreements enable the guarantee agency to

participate in the GSLP and the PLUS Program and to receive the various payments and benefits incident to that participation."

5. Section 682.410(a)(1) of Title 34 of the Code of Federal Regulations. (App. 33A-35A).

STATEMENT OF THE CASE

This case involves the Higher Education Act of 1965, Pub. L. 89-329, 79 Stat. 1219 as amended [20 U.S.C. § 1071, et seq. (1988)] (the "Higher Education Act") under which the Secretary of Education (the "Secretary") is authorized to administer the Guaranteed Student Loan Program (the "GSLP"). The North Carolina Education Assistance Authority (the "NCSEAA") operates the North Carolina Insured Student Loan Program and participates in the GSLP under several contracts with the Secretary.

The NCSEAA is a political subdivision of the State of North Carolina. The North Carolina General Assembly created the NCSEAA in 1965 to administer a system of financial assistance for qualified students to enable them to obtain an education beyond the high school level. To fulfill that mandate the NCSEAA developed the North Carolina Insured Student Loan Program [the "NCISLP"]. Under the NCISLP banks and other investors, such as private colleges and universities, deposit funds with College Foundation, Inc.[1] which they desire to lend to students. College Foundation, Inc. then lends the money invested to eligible students. The NCSEAA insures these loans from default. The cost of that insurance is paid in part with insurance premiums collected from the borrower. When the students repay their loans, the College Foundation distributes a pro rata share of the principal and interest, less a processing fee, to the

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1 College Foundation, Inc. is a private, non-profit corporation created in in 1965 at the behest of the North Carolina government to serve as a central educational lending and servicing agency for student loans.

investors. When a student defaults on a loan, the NCSEAA buys the loan from the College Foundation for the principal sum plus accrued interest. The College Foundation then distributes those funds to the investors while the NCSEAA undertakes to collect the defaulted student loan.

In order to fulfill its obligation to insure the student loans made under the NCISLP, the NCSEAA, pursuant to N.C. Gen. Stat. § 116-209, is authorized to and, since 1966, has maintained a cash reserve known as the Reserve Trust Fund. Over the years the NCSEAA has deposited money from various sources in the Reserve Trust Fund.

On 2 August 1977, the NCSEAA and the Secretary entered into an agreement entitled "Supplemental Guaranty Agreement for Federal Re-Insurance of Loans Higher Education Act of 1965, As Amended" [the "Supplemental Guaranty Agreement"]. (App. 36A-43A). Under the terms of the Supplemental Guaranty Agreement, the Secretary agreed to reimburse the NCSEAA 100% of the amount expended by the NCSEAA in discharge of its insurance obligations under the NCISLP for losses resulting from the default of student borrowers on the unpaid balance of the principal and accrued interest of any student loan insured under the NCISLP, provided the amount reimbursed by the Secretary does not exceed five percent (5%) of the loans which are insured by the NCSEAA and in repayment at the end of the preceding fiscal year. The Supplemental Guaranty Agreement requires the Secretary to pay ninety percent (90%) of those defaults in excess of five percent (5%) of the insured loans in repayment the preceding year and eighty percent (80%) of those defaults in excess of nine percent (9%) of the insured loans in repayment the preceding year. (App. 37A-38A). Under the Supplemental Guaranty Agreement, once the Secretary has made reimbursement payments to the NCSEAA on any loan, he is entitled to an equitable share, as determined under § 428(c)(6) of the Higher Education Act [20 U.S.C. § 1078(c)(6) (1988)], of any payment received by the NCSEAA in discharge of the obligations incurred by

the borrower with respect to that loan. The NCSEAA deposits the reimbursement payments made under the Supplemental Guaranty Agreement in the Reserve Trust Fund. Since September 1986, the NCSEAA has paid the Secretary a reinsurance fee of one quarter of one percent (0.25%) of the total principal amount of the covered loans upon which insurance was issued by the NCSEAA during the fiscal year.

As of December 22, 1987, the Reserve Trust Fund contained $1,184,000.00 in appropriations from the North Carolina General Assembly as well as insurance premiums, Administrative Cost Allowance payments, reimbursement payments, other payments, revenue interest, and other income the NCSEAA has received in connection with obligations under the NCISLP. Pursuant to N.C. Gen. Stat. § 116-209, the Reserve Trust Fund also includes a dedicated portion of the North Carolina Escheat Fund.

On December 22, 1988, the Congress passed and the President signed into law the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (1987) (the "OMBR"). Section 3001 of the OMBR (the "1987 Amendments") (App. 26A-31A), entitled "Recovery of Excess Cash Reserves Accumulated under the Guaranteed Student Loan Program," amended the Higher Education Act to give the Secretary the authority to seize funds on deposit in the NCSEAA's Reserve Trust Fund.

In particular the 1987 Amendments amend the Higher Education Act by adding a new § 422(e) [20 U.S.C. § 1072(e) (1988)]. (App. 26A-30A). This new section prohibits guaranty agencies such as NCSEAA from accumulating cash reserves in excess of certain amounts to be determined in accordance with specified formulas. (App. 26A). Prior to the passage of the 1987 Amendments, neither Congress nor the Secretary had interfered with the guaranty agencies' authority to accrue reserves to a level they deemed appropriate for their needs.

Once the Secretary has determined the "maximum cash reserve" for each guaranty agency, § 422(e)(2) [20 U.S.C. § 1072(e)(2) (1988)] requires the Secretary to direct the guaranty agencies to eliminate a total of $250 million of those "excess cash reserves" during the 1988-89 fiscal year. (App. 27A). The guaranty agencies are required to eliminate their "excess cash reserves" by transferring a sum equal to their "excess cash reserves" to the United States by one or more methods, including withholding or cancelling claims for reimbursement due them under any supplemental guaranty agreements. (App. 27A, ¶(2)(B)).

When the NCSEAA refused to voluntarily transfer its "excess cash reserves," the Secretary informed the NCSEAA that pursuant to § 422(e)(2)(B) of the Higher Education Act [20 U.S.C. § 1072(e)(2)(B) (1988)] (App. 27A, ¶(2)(B)) he would withhold reimbursement payments due the NCSEAA under the Supplemental Guaranty Agreement until the Department of Education had recovered $2,632,785.00 from the NCSEAA. Since that date the Secretary has actually withheld the entire $2,632,785.00 due the NCSEAA under the terms of the Supplemental Guaranty Agreement.

On December 1, 1988, the State of North Carolina and the NCSEAA filed a verified complaint in which they alleged that by passing and enforcing the 1987 Amendments, the United States and the Secretary had violated the NCSEAA's rights under the Fifth, Tenth and Fourteenth Amendments to the Constitution of the United States, the laws of the United States, including the Higher Education Act, and several contracts between the parties executed pursuant to that Act. The complaint did not seek monetary damages but rather requested only declaratory and ancillary injunctive relief. The Secretary served his answer on January 30, 1989. On February 27, 1989, the NCSEAA moved for summary judgment. On April 7, 1989, the Secretary moved for summary judgment. On July 20, 1989, the Honorable Terrence W. Boyle, United States District Judge for the Eastern District of North Carolina, entered an order denying the

NCSEAA's motion for summary judgment and granting the Secretary's motion for summary judgment. (App. 15A-22A). The NCSEAA gave notice of appeal on July 25, 1989.

On appeal this case was consolidated with the appeal in ***South Carolina Education Assistance Authority v. Cavazos***, 716 F. Supp. 886 (D.S.C. 1989) and the appeal in ***Maryland Higher Education Loan Corporation v. Cavazos***, No. S-89-270 (D. Md. 1989).

On March 7, 1990, the Fourth Circuit Court of Appeals handed down its decision affirming the district court's decision in this case and reversing the decisions of the Maryland and South Carolina district courts. (App. 1A-12A). On March 20, 1990, the State of North Carolina and NCSEAA filed a petition for rehearing and suggestion for rehearing in banc. On March 28, 1990, the Fourth Circuit Court of Appeals denied the State of North Carolina's and the North Carolina State Education Assistance Authority's petition for rehearing and suggestion for rehearing in banc. (App. 23A-25A).

REASONS WHY THE COURT SHOULD ALLOW THE WRIT

I. THE COURT OF APPEALS' DECISION THAT THE NCSEAA DID NOT HAVE A PROPERTY INTEREST SUBJECT TO FIFTH AMENDMENT PROTECTION IN THE MONEY WHICH IT KEEPS ON DEPOSIT IN THE RESERVE TRUST FUND TO MEET ITS INSURANCE OBLIGATIONS TO PRIVATE LENDERS WHO HOLD DEFAULTED STUDENT LOANS NOT ONLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT BUT ALSO DECIDED IT IN A WAY WHICH CONFLICTS WITH APPLICABLE DECISIONS OF THIS COURT.

The Court of Appeals' decision is in conflict with the decisions of this Court pertaining to the nature of property interests protected under the takings clause of the fifth amendment. Furthermore, pursuant to the 1987 Amendments and the Court of Appeals' decision, the Secretary is now free to seize $250 millions of dollars of private funds held by guaranty agencies participating in the GSLP. That fact, as well as the fact that twenty-seven of the forty-six guaranty agencies participating in the GSLP have filed suits against the Secretary contesting the constitutionality of the 1987 Amendments,

is proof that this case presents important issues of federal law which have not, but should be, decided by this Court.[2]

The Fifth Amendment to the United States Constitution provides that "private property [shall not] be taken for public use without just compensation." The "private property" protected under the Fifth Amendment includes property owned by State and local governments. ***United States v. 50 Acres of Land***, 469 U.S. 24, 31 (1984); ***United States v. Carmack***, 329 U.S. 230 (1946). In ***United States v. General Motors Corp.***, 323 U.S. 373, 378 (1945) this Court

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2 Aside from the NCSEAA, the South Carolina Education Assistance Authority and the Maryland Higher Education Loan Corporation, twenty-three other guaranty agencies have challenged the constitutionality of the 1987 Amendments. See ***Student Loan Guarantee Foundation of Arkansas, Inc. v. Cavazos***, No. LR-C-88-862 (E.D. Ark. filed Dec. 15, 1988); ***Colorado v. Cavazos***, No. 88-C-2073 (D. Col. filed Dec. 22, 1988) (consolidated with suits filed by Montana, New Mexico, North Dakota, and Utah); ***Connecticut Student Loan Foundation v. Cavazos***, No. H89-182 (D. Conn. Jan. 10, 1990); ***Delaware v. Cavazos***, 723 F. Supp. 234 (D. Del. 1989); ***Georgia Student Finance Commission v. Cavazos***, No. 1:89-CV-160-MHS (N.D. Ga. filed Jan. 26, 1989); ***Indiana v. Cavazos***, No. IP 89-125-C (S.D. Ind. Jan. 29, 1990); ***Iowa v. Bennett***, No. 88-142-B (S.D. Iowa filed Mar. 15, 1988); ***Maine State Board of Education v. Cavazos***, No. 88-0273-B (D. Me. filed Nov. 23, 1988); ***Massachusetts Higher Education Assistance Corp. v. Cavazos***, No. 89-1325-K (D. Mass. filed June 5, 1989); ***Michigan Higher Education Authority v. Cavazos***, No. L89-400/8CA (W.D. Mich. filed Feb. 13, 1989); ***Missouri Coordinating Board of Higher Education v. Cavazos***, No. 88-4576-CV-C9 (W.D. Mo. filed Dec. 15, 1988); ***New Hampshire Higher Education Assistance Foundation v. Cavazos***, No. C88-4-56-D (D.N.H. filed Nov. 16, 1988); ***Ohio Student Loan Commission v. Cavazos***, 709 F. Supp. 1411 (S.D. Ohio 1988), *reversed*, 900 F.2d 898 (6th Cir. 1990); ***Puerto Rico Higher Education Assistance Authority v. Cavazos***, No. 89-3069-TPH (D.D.C. filed Nov. 9, 1989); ***Rhode Island Higher Education Assistance Authority v. Cavazos***, No. 89-0015T (D.R.I. filed Jan. 9, 1989); ***Education Assistance Authority v. Cavazos***, __ F.2d __, No. 89-5393 (8th Cir. 1990) (South Dakota); ***Tennessee Student Assistance Corp. v. Cavazos***, No. 389-0261 (M.D. Tenn. filed Dec. 29, 1989); ***Virginia State Education Assistance Authority v. United States***, No. 88-0874-R (E.D. Va. filed Dec. 1988); ***Great Lakes Higher Education Corp. v. Cavazos***, 711 F. Supp. 485 (W.D. Wis. 1989), *appeal pending*, No. 89-2748 (7th Cir.).

described the property interests protected under the fifth Amendment as that "group of rights inhering in the citizen's relation to the physical thing, as the right to possess, use and dispose of it" and includes "every sort of interest the citizen may possess." This Court has also said that the right of "free use, enjoyment and disposal" are indicative of "private property." ***Buchanan v. Warley***, 245 U.S. 60, 74 (1917) (in which the Court addressed the issue under the due process clause of the fourteenth amendment). This Court has also said, "The right to exclude others is generally 'one of the most essential sticks in the bundle of rights that are commonly characterized as property.'" ***Ruckelshaus v. Monsanto Co.***, 467 U.S. 986, 1011 (1984), (quoting ***Kaiser Aetna***, 444 U.S. 164 *at* 176 (1979)).

Among the property interests which the Supreme Court has held to be protected under the fifth amendment are interests in real property, ***United States v. 50 Acres of Land***, 469 U.S. 24, money and the right to be paid money, ***Perry v. United States***, 294 U.S. 330 (1934), and interests in contracts with the United States Government, ***Lynch v. United States***, 292 U.S. 571, 579 (1933). Furthermore, in the ***Sinking Fund Cases***, 99 U.S. 700, 720 (1879) the Supreme Court held that the fifth amendment prohibits the United States from depriving persons of the "fruits actually reduced to possession of contracts lawfully made" with the United States.

The Court of Appeals decided that the NCSEAA did not have a property interest protected under the fifth amendment in the money which the NCSEAA keeps on deposit in the Reserve Trust Funds to meet its insurance obligations to private lenders who have made student loans insured under the NCISLP. ***South Carolina State Education Assistance Authority v. Cavazos***, 897 F.2d 1272, 1276 (4th Cir. 1990); (App. 11A). The Court of Appeals decision on this point was explicitly based on its determination that federal regulations, 34 C.F.R. § 682.410(a)(1) and 682.410(a)(2) (App. 33A-34A), completely control the reserve funds use and, therefore, they are "the sort of 'existing rules or understandings' which prevent any of the guaranty agencies form acquiring an ownership interest in its reserve

fund which would entitle it to protection as private property under the Takings Clause." *Id.*, (*quoting*, ***Ruckelshaus v. Monsanto Co.***, 467 U.S. 986 (1984). In reaching this determination, the Court of Appeals not only misread the pertinent regulations but also a failed to give effect to other independent, existing rules and understandings governing the Reserve Trust Fund. The decision below therefore is in conflict with the decisions of this Court which set the standards for determining when a person, corporation, or state possesses a property interest subject to fifth amendment protection.

First, the Court of Appeals' determination that the federal regulations control the NCSEAA's use of its Reserve Trust Fund is based on a misreading of 34 C.F.R. § 682.410(a)(2) and the Secretary's remedies for breach of that regulation. 34 C.F.R. § 682.410(a)(2) does not prohibit the NCSEAA from using the money in the Reserve Trust Fund for any purpose it may choose. That regulation merely limits the purposes for which the NCSEAA may use the money in the Reserve Trust Fund and continue to qualify for participation in the GSLP. The correct construction of 34 C.F.R. § 682.410(a)(2) becomes clear when the limitations contained therein are read in the context of 20 U.S.C. § 1078(c)(1)(A) (1988) which states, "The Secretary may enter into a guaranty agreement with any guaranty agency . . ." (App. 32A) and 34 C.F.R. § 682.400 which states, "The Secretary enters into agreements with a guarantee agency whose loan guarantee program meets the requirements of this subpart."

The limitations recited in 34 C.F.R. § 682.410 are simply some of the requirements which the Secretary must assure himself that the NCSEAA has met before the Secretary may enter into a reinsurance agreement with the NCSEAA. This reading of the regulations is supported by the fact that the first substantive paragraph of the Supplemental Guaranty Agreement states: "Based on the above assurances, the [Secretary] determines that the Agency is eligible to enter into this Supplemental Guaranty Agreement." (App. 37A, ¶1). Therefore, it is evident that, rather than restrict the NCSEAA's

authority to possess, use or dispose of the money in its Reserve Trust Fund, the regulations actually restrict the Secretary's authority to contract with the NCSEAA.

If the NCSEAA were to use the Reserve Trust Fund for purposes other than those specified in 34 C.F.R. § 682.410(a)(2), the Secretary's remedies are limited to those specified in the Supplemental Guaranty Agreement. (App. 42A, ¶10). A review of those remedies indicates that, if the NCSEAA failed to comply with the terms of 34 C.F.R. § 682.410(a)(2), the only remedy that the Secretary has is to terminate the agreement. In that event the Secretary must give the NCSEAA appropriate notice and an opportunity for a hearing. Furthermore, the Supplement Guaranty Agreement specifically provides that termination will have no effect on reimbursement obligations the Secretary incurred before the effective date of the termination. (App. 42A, ¶10).

The contract does give the Secretary the right to withhold payments due to the NCSEAA if it violates any of the provisions of the Act or its regulations. The agreement, however, limits that authority to those cases where the NCSEAA fails to provide adequate documentation of its claims for reimbursement. (App. 42A, ¶ 10). Furthermore, the agreement does not give the Secretary the right to demand that the NCSEAA reimburse him for improperly spent reserve funds. Under the terms of the Supplemental Guaranty Agreement, in the event the NCSEAA fails to comply with the Higher Education Act or its regulations, the Secretary's remedy is limited to demanding that the NCSEAA reimburse the Secretary only for those payments which the Secretary has made or is obligated to make "as a result of the agency making such incomplete or incorrect statements or violating such provisions of this agreement or applicable federal law or regulations." (App. 42A, ¶10). Consequently, even if the Secretary had alleged that the NCSEAA failed to comply with applicable federal laws or regulations, which he has not, he may demand reimbursement only if he paid money to the NCSEAA as a result of its breach. Insofar as the NCSEAA's use the Reserve Trust

Fund for purposes other than those specified in 34 C.F.R. § 682.410 could not cause the Secretary to make payment or become obligated to make payments, a demand for reimbursement would not be a remedy available to the Secretary under those circumstances.

Finally, the Secretary cannot rely on his general remedial power under the Supplemental Guaranty Agreement to withhold payments from or demand reimbursements from the NCSEAA should it use its reserve funds for purposes other than those specified in 34 C.F.R. § 682.410. Under the general remedial provisions of the agreement, the Secretary may "take such action short of termination as may be necessary to protect the interests of the United States." (App. 42A, ¶10). However, the NCSEAA's use of the Reserve Trust Fund for purposes other than those specified in 34 C.F.R. § 682.410 could not jeopardize the interests of the United States because the United States is not liable for any of the claims which the Reserve Trust Fund could be used to pay under 34 C.F.R. § 682.410(a)(2). The fact is, the NCSEAA maintains the Reserve Trust Fund to cover its insurance obligations to private lenders participating in the NCISLP. Those lenders have no insurance contracts with the Secretary and the United States is not liable for any of the claims specified in 34 C.F.R. § 682.410(a)(2). Consequently, an unauthorized expenditure of reserve funds could not effect any interest of the United States. Absent a risk to the interests of the United States, the Secretary has no authority to use his general remedial powers to deny funds to or seize funds simply because the NCSEAA might use the Reserve Trust Fund contrary to the terms of 34 C.F.R. § 682.410.

Aside from misreading the federal regulations applicable the to the Reserve Trust Fund, the Court of Appeals ignored the independent, existing rules or understandings arising under North Carolina law, the Higher Education Act and the agreements between the NCSEAA and the Secretary of Education that create the NCSEAA's property interest in the Reserve Trust Fund. Consideration of those rules and understandings clearly demonstrates that the

NCSEAA has a private property right entitled to fifth amendment protection in the money in the Reserve Trust Fund.

First, the Reserve Trust Fund was created by an act of the North Carolina General Assembly in 1966 to be used exclusively for the purpose of acquiring contingent or vested rights in obligations which the NCSEAA acquired under the NCISLP. N.C. Gen. Stat. § 116-209. The fact that the Reserve Trust Fund was created under North Carolina law, not federal law, is a strong indication that the Reserve Trust Fund belongs to the State of North Carolina, not the United States.

Second, the money in the Reserve Trust Fund is used to pay the NCSEAA's obligations on insurance agreements it has with lenders that participate in the NCISLP. The fact that the Reserve Trust Fund is used to pay the debts of the NCSEAA, not the United States, is virtually irrefutable proof that the Secretary, the NCSEAA and the lenders participating in the NCISLP understood that the money on deposit in the Reserve Trust Fund was the property of the NCSEAA. The NCSEAA, of course, may subsequently seek reimbursement from the Secretary under its reinsurance agreements. However, if the NCSEAA or the lender has not properly handled the defaulted loan, the Secretary is not obligated to pay the reinsurance claim. Consequently, the Court of Appeals' decision that the money in the Reserve Trust Fund is the property of the United States, rather than the NCSEAA, leads to the illogical conclusion that the NCSEAA is using federal funds to pay its debts.

Third, the express purpose of the Higher Education Act of 1965 was to "encourage State and nonprofit private institutions and organizations to establish adequate loan insurance programs for students in eligible institutions." 20 U.S.C. § 1071(a)(1)(A) (1988). The Higher Education Act achieves its purpose by authorizing the Secretary to enter into various contracts with state guaranty agencies that establish and operate their own independent insured student loan programs. The NCSEAA could not establish or operate an insured

loan program without money in its Reserve Trust Fund to cover its insurance obligations. It is inconceivable that the NCSEAA would have voluntarily established an insured student loan program and assumed insurance obligations under contracts with private lenders without possession or control of any of the funds necessary to pay its obligations under those contracts. Yet, that is exactly what the Court of Appeals' found when it held that the money in the Reserve Trust Fund is not the private property of the NCSEAA. Furthermore, insofar as the private lenders have no insurance agreement with the Secretary and the Secretary is under no obligation to make reimbursements directly to the lenders on defaulted student loans, the Court of Appeals also implicitly found that the private lenders participating in the NCISLP have made millions of dollars of high risk student loans on the basis of insurance agreements with a guaranty agency which does not possess any funds to cover its obligations.

Finally, the Supplemental Guaranty Agreement expressly recognizes that the NCSEAA is operating its own insured student loan program, separate and apart from any agreement with the Secretary, and that the NCSEAA, as the guaranty agency, is maintaining it own reserve fund to cover its insurance obligations. The Supplemental Guaranty Agreement expressly provides that the NCSEAA is the entity insuring the student loans. (App. 36A-37A, second "Whereas" clause, "borrowers receiving student loans insured by the Agency"; fifth "Whereas" clause, "any loan insured under the Agency's Student Loan Insurance Program"; ¶2 "any student loan insured under the Agency's Student Loan Insurance Program"). The Supplemental Guaranty Agreement also specifically refers to the Reserve Trust Fund as "the Agency's reserve funds," not the Secretary's. (App. 36A-38A, third and fifth "Whereas" clauses and ¶3). The Supplemental Guaranty Agreement's recognition of the fact that the NCSEAA is insuring the student loans and the fact that the reserve funds belong to the NCSEAA are the sort of "existing rules and understandings" which prove that the NCSEAA has a private property interest in the Reserve Trust Fund.

In summary, the independent, existing rules and understandings regarding the NCSEAA's Reserve Trust Fund leave no doubt that prior to the 1987 Amendments the private lenders participating in the NCISLP, the NCSEAA and the Secretary all understood that the NCSEAA owned the Reserve Trust Fund. The fact that North Carolina law requires that the money in the Reserve Trust Fund be used for the public purpose of insuring student loans under the NCISLP does not diminish the NCSEAA's right to exclude the Secretary from seizing those funds. ***See United States v. Carmack***, 329 U.S. 230 *at* 242 (1946) (Federal Government must pay just compensation for condemned property controlled by state or local subdivision). Therefore, the money in the Reserve Trust Fund is the "private property" of the NCSEAA and the Court of Appeals' decision to the contrary conflicts with those decisions of this Court, cited above, which hold that the States have private property rights protected under the takings clause in that property to which they have the free use, enjoyment and disposal.

II. THE COURT OF APPEALS' DECISION THAT THE NCSEAA DID NOT HAVE A VESTED CONTRACTUAL RIGHT, SUBJECT TO FIFTH AMENDMENT PROTECTION, TO RECEIVE REIMBURSEMENT PAYMENTS UNDER ITS SUPPLEMENTAL AGREEMENT WITH THE SECRETARY NOT ONLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT BUT ALSO DECIDED IT IN A WAY WHICH CONFLICTS WITH APPLICABLE DECISIONS OF THIS COURT.

Again, the fact that this petition presents an issue identical to that presented in more than twenty suits against the Secretary, brought by both state and private guaranty agencies, proves that this petition presents an important issue of federal law which has not been, but should be, settled by this Court. Furthermore, the Court of Appeals' decision that the NCSEAA does not have a property interest in the

reimbursement payments owed it under the Supplemental Guaranty Agreement conflicts with the decisions of this Court's pertaining to an individual's acquisition of vested contract rights in agreements with the United States.

In the Supplemental Guaranty Agreement, the Secretary obligated the United States to reimburse the NCSEAA for up to 100% of the amount the NCSEAA expended in the discharge of its insurance obligations incurred under the NCISLP. (App. 36A-43A). In the complaint, the NCSEAA claimed that the 1987 Amendments took the NCSEAA's right to reimbursement under its Supplemental Guaranty Agreement with the Secretary in violation of its fifth amendment rights. The Court of Appeals, however, held "that the state agencies' 'contractual rights' to reimbursement payments had not 'vested' so as to trigger Fifth Amendment protections." ***South Carolina Education Assistance Authority v. Cavazos***, 897 F.2d *at* 1276; (App. 11A). This holding was based on the court's determination that:

> Just as the complete federal control over the use of the fund compels the conclusion that the targeted funds do not constitute private property for Fifth Amendment purposes, the contractual right to reimbursement payments destined for inclusion in such reserve funds similarly is not the the type of property subject to the 'takings' prohibition. The reservation of the power to amend the terms of the GSL program prevents the participating state agencies from invoking the Fifth Amendment Takings bar against subsequent Congressional action.

Id. at 1277; (App. 12A).

As the NCSEAA has noted above, the Court of Appeals misread the federal regulations and ignored the independent, existing rules and understandings which created and defined the NCSEAA's property interest in the Reserve Trust Fund. Therefore, the Court of Appeals' finding that "complete federal control over the use of the

fund" precludes the NCSEAA from asserting a private property interest in its right to reimbursement under the Supplemental Guaranty Agreement is also in conflict with the decisions of this Court cited above.

The Court of Appeals' alternate holding, that the "reservation of power to amend the terms of the GSL program prevents the participating state agencies from invoking the Fifth Amendment Takings bar against subsequent Congressional action," *Id.*, conflicts with several decisions of this Court regarding Congress' authority to amend statutes which effect the rights of parties to agreements with the United States.

First, in both ***Lynch v. United States***, 292 U.S. 573, 577-580 (1933) and the ***Sinking Fund Cases***, 99 U.S. 700, 719-722 (1879) this Court stated that, despite the fact the statutes authorizing the United States to enter into contracts or the contracts themselves expressly reserved Congress' right to amend the agreements, Congress cannot exercise that authority to deprive parties to contracts with the United States of their vested rights without just compensation. The Court recently reaffirmed this limitation on the Congress' authority under the spending clause in ***Pennhurst State School v. Halderman***, 451 U.S. 1, 17 (1981) where the Court held that any restrictions which Congress intends to impose upon the receipt of federal funding must be unambiguously stated before the State agrees to accept the funding so that the State may exercise its choice to accept or reject the federal funding "knowingly, cognizant of the consequences of their participation." ***See also South Dakota v. Dole***, 483 U.S. 203, 207 (1987). Any subsequent conditions which the Congress places on the receipt of federal funding must be given prospective effect only. ***Pennhurst State School v. Halderman***, 451 U.S. *at* 25 ("Though Congress' power to legislate under the spending power is broad, it does not include surprising participating states with post acceptance or 'retroactive' conditions."); cf., ***FHA v. Darlington***, 358 U.S. 84, 91 (1958) ("The new act applies prospectively only. So there is no possible due process issue on that score."); ***Fleming v. Rhodes***, 331

U.S. 100, 107 (1946) ("Federal regulation of future action based upon rights previously acquired by the person regulated is not prohibited by the Constitution."); ***Harris v. McCrae***, 448 U.S. 297 (1980) (changes in federal funding for medicare abortions eliminates States' responsibility to fund future abortions).

Thus, contrary to the Court of Appeals' decision, even in those cases where Congress expressly reserves the right to amend its agreements, either by statute or by contract, the reservation of that authority does not preclude parties from attaining vested rights under the agreements and Congress cannot amend the statutes or contracts to abrogate those rights which have become vested.

Second, the Court of Appeals' decision ignores the fact that prior to the 1987 Amendments the Higher Education Act expressly granted the NCSEAA and other guaranty agencies "a contractual right against the United States, during the life of [an insured] loan, to receive reimbursement according to the provisions of this subsection." 20 U.S.C. § 1078(c)(1)(A) (Supp. IV 1986) (App. 32A). Thus, prior to the 1987 Amendments, Congress itself had unambiguously stated that it intended the NCSEAA to have vested contractual rights in the reimbursement payments due it under the Supplemental Guaranty Agreement. In ***Bowen v. Agencies Opposed to Social Security Entrapment***, 477 U.S. 41, 52 (1986), this Court accepted as given that "the Federal Government, as sovereign, has the power to enter contracts that confer vested rights, and the concomitant duty to honor those rights." The language of the Higher Education Act clearly demonstrated that prior to the 1987 Amendments Congress had exercised its sovereign power to authorize the Secretary to enter into contracts which conferred vested rights on the NCSEAA. The Court of Appeals is bound to honor that Congressional intent and should have required the Secretary to honor those rights.

The Court of Appeals, however, chose to rely on that portion of ***Bowen*** wherein this Court held "that the power to amend is deemed to have been reserved unless it is expressly relinquished."

Bowen v. Agencies Opposed to Social Security Entrapment, 477 U.S. at 52; ***South Carolina Education Assistance Authority v. Cavazos***, 897 F.2d *at* 1275 (App. 10A). The Court of Appeals, therefore, decided that the fact the Higher Education Act did not expressly reserve the right to alter or amend its provisions did not preclude Congress from enacting those provisions of the 1987 Amendments which authorize the Secretary to seize the NCSEAA's "excess cash reserves."

This portion of the Court of Appeals decisions ignores and is inconsistent with this Court decisions in cases such as ***Lynch v. United States***, 292 U.S. *at* 576-577 (1933) and ***White v. United States***, 270 U.S. 175, 179-180 (1925) and ***Bowen v. Agencies Opposed to Social Security Entrapment***, 477 U.S. *at* 52 (1986) in which the Court recognized that an individual may acquire vested property interests in federal contracts, which are protected under the takings clause of the fifth amendment, irrespective of Congress' expressed or unexpressed reservaton of the power to amend the agreements in question.

Finally, the Court of Appeals decision that the NCSEAA could have no vested contract rights in the Supplemental Guaranty Agreement because the GSLP and the NCISLP are part of a "comprehensive federal/state social welfare program" is not supported by the law or the facts and conflicts with this Court's holdings in ***Lynch v. United States***, 292 U.S. *at* 576 (1933), ***White v. United States***, 270 U.S. at 180 (1925). Those cases are similar to the present case in that they involved the Federal Government's decision to provide for the public welfare by authorizing federal agencies to enter into binding contracts.

Lynch and ***White*** involved Congress' attempts to amend the act which created the Bureau of War Risk Insurance and authorized it to offer contracts of insurance to veterans of the First World War. Like the contracts at issued here, the United States did not enter into those insurance contracts with the intent of making a profit. Rather,

the United States offered the insurance for the benevolent purpose of providing pensions, compensation allowances, hospital and other privileges to members of the armed forces and their beneficiaries. ***White v. United States***, 270 U.S. *at* 180; ***Lynch v. United States***, 292 U.S. *at* 576-577. Nevertheless, the insured parties gave consideration for the policies and this Court explicitly recognized that "the policies, although not entered into for gain, are legal obligations of the same dignity as other contracts of the United States and possess the same legal incidents." ***Lynch v. United States***, 292 U.S. at 576. As such, the rights vested under those contracts were entitled to protection under the fifth amendment irrespective of the fact that the contracts were part of a federal welfare program or the fact that the certificates of insurance expressly stated that they were subject to subsequent amendments to the act or the regulations. Id. at 577.

Like the War Risk Insurance program, the GSLP is a federal welfare program effected through binding contracts between the United States and the guaranty agencies, both state and private, that desire to participate in the program. First, like the War Risk Insurance program, the GSLP is an insurance program under which the United States enters into contracts to provide insurance coverage to the participants. Second, like the holders of Was Risk Insurance policies, the NCSEAA pays the Secretary good and valuable consideration in the form of a reinsurance fee equal to 0.25% of the total principal amount of the covered loans upon which the NCSEAA issued insurance during the fiscal year. 20 U.S.C. § 1078(c)(9) (1988).

Finally, prior to the 1987 Amendments, 20 U.S.C. § 1078(c)(1)(A) (Supp. IV 1986) (App. 32A) expressly stated that any guaranty agency that entered into reinsurance agreement with the Secretary would "be deemed to have a contractual right against the United States, during the life of [an insured] loan, to receive reimbursement according to the provisions of this subsection." Thus, Congress clearly stated that it intended the NCSEAA to acquire vested contractual rights in the reimbursements due it under the Supplemental Guaranty Agreement.

In contrast, the GSLP bears little resemblance to the Social Security System which was at issue in Bowen. Unlike the Social Security System, the participation in the GSLP is not mandatory. The NCSEAA, which was created to operate the NCISLP, is a voluntary participant in the GSLP. Unlike the Social Security System which confers no contractual rights on anyone associated with the program, ***Flemming v. Nestor***, 363 U.S. 603, 609-611 (1960), the NCSEAA has entered into insurance contracts with private lenders which give those lenders contractual rights to payment on defaulted student loans under the NCISLP. The NCSEAA entered into the Supplemental Guaranty Agreement in order to reinsure a portion of its liability on those insurance policies. Finally, unlike the Social Security System, the GSLP is not "of necessity a highly complicated and interrelated statutory structure." *Id.* at 610. The sale of reinsurance is a normal and regular part of any insurance business. While the United States may not have entered into the Supplemental Guaranty Agreement for a business purpose, the terms of that agreement "are legal obligations of the same dignity as other contracts of the United States and possess the same legal incidents." ***Lynch v. United States***, 292 U.S. *at* 576.

Like all government programs and activities, the NCISLP and the GSLP exist for the general public good. The NCISLP provides for the public welfare by permitting the NCSEAA to insure student loans. This encourages private lenders to make loans to students who otherwise would not qualify for loans. The GSLP provides for the public welfare by permitting the Secretary to enter into reinsurance agreements with guaranty agencies such as the NCSEAA. This permits the NCSEAA to insure more loans than it could if it had to rely exclusively on its reserve funds to backup its insurance agreements.

Thus, unlike the Social Security System, the legally binding contractual relationships among the private lenders, the NCSEAA and the Secretary are the very heart and soul of the student loan program. If the NCSEAA cannot rely on the Secretary to perform on

his reinsurance agreements, the NCSEAA cannot be sure it will have the funds to cover its insurance obligations to the private lenders who make the loans to the students. If the lenders cannot be sure that adequate funds exist to cover the NCSEAA's insurance obligations, they will not make the loans to the students. Unlike the employees in the Social Security System, the private lenders' participation in the NCISLP is not mandatory; they are not likely to continue to lend money without assurances that the NCSEAA has the reserve funds to backup its insurance agreements. Therefore, the Court of Appeals' decision to permit the Secretary to renege on his reinsurance agreement undermines the relationship between the NCSEAA and its insured private lenders' and threatens the entire student loan system.

In summary, the Court of Appeals erred when it relied on this Court's holding in ***Bowen*** to support its decision that, like the Social Security System, the GSLP was a federal/state welfare program under which the NCSEAA could not acquire vested contractual rights. All the facts indicate that Congress intended the NCSEAA to have and the NCSEAA does have a vested, contractual right to reimbursement under the Supplemental Guaranty Agreement. That vested right is the property of the NCSEAA and, as such, is entitled to protection under the fifth amendment. The Court of Appeals decision to the contrary is in conflict with the decisions of this Court cited above.

CONCLUSION

For the reasons stated, the petitioners believe that the Court of Appeals' decision conflicts with the decisions of this Court and that this case presents an important federal question which has not been, but should be, decided by this Court. Therefore, the Court should issue the writ in order to settle the important federal questions presented and correct the Court of Appeals' decision.

Respectfully submitted this the 26th day of June 1990.

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APPENDICES A-H

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff - Appellee

V.

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA HIGHER STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiff - Appellee

V.

LAURO F. CAVAZOS, Secretary of Education;
U.S. DEPARTMENT OF EDUCATION

Defendants - Appellants

NATIONAL COUNCIL OF HIGHER
EDUCATION LOAN PROGRAMS, INC.;
VIRGINIA STATE EDUCATION
ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the District of South Carolina, at Columbia. Karen L. Henderson, District Judge. (CA-88-2710-16-3)

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofit Maryland Corporation

Plaintiff - Appellee

V.

LAURO F. CAVAZOS, Secretary of the United States Department of Education

Defendant - Appellant

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the District of Maryland, at Baltimore. Frederic N. Smalkin, District Judge. (CA-89-270-S)

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

Plaintiffs - Appellants

V.

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION

Defendants - Appellees

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY

Amici Curiae

Appeal from the United States District Court for the Eastern District of North Carolina, at Raleigh.. Terrence W. Boyle, District Judge. (CA-88-961-CIV-5)

Argued: October 3, 1989 Decided: March 7, 1990

Before RUSSELL, WIDENER, and HALL, Circuit Judges.

Affirmed in part, reversed in part, and remanded with instructions by published opinion. Judge Hall wrote the opinion, in which Judge Russell and Judge Widener joined.

Neil H. Koslowe, Special Litigation Counsel (Stuart E. Schiffer, Acting Assistant Attorney General; William Kanter, Deputy Director, Civil Division, DEPARTMENT OF JUSTICE; Edward C. Stringer, General Counsel; Harold Jenkins, Brian Seigel, Attorneys, DEPARTMENT OF EDUCATION, on brief) for Appellants. Andrew H. Baida, Assistant Attorney General (J. Joseph Curran, Jr., Attorney General; William F. Howard, Mary L. Preis, Assistant Attorneys General), on brief); James Emory Smith, Jr. (Joseph D. Shine, Attorney General's Office; N. Bruce Holland, DEPARTMENT OF SOCIAL SERVICES, on brief); Thomas J. Ziko, Assistant Attorney General (Lacy H. Thornburg, Attorney General; Edwin M. Speas, Jr., Special Deputy Attorney General, on brief) for Appellees. (Jean Frohlicher, NCHELP, Inc.; George G. Olsen, Robert E. Jensen, WILLIAMS AND JENSEN, P.C., on brief) for Amicus Curiae NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC. (Mary Sue Terry, Attorney General; R. Claire Guthrie, Deputy Attorney General; Paul J. Forch, Senior Assistant Attorney General and Chief, Education Section; Richard C. Kast, Assistant Attorney General, on brief) for Amicus Curiae VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY.

HALL, Circuit Judge:

These consolidated appeals arise from actions filed by three different state-created agencies against the Secretary of the United States Department of Education ("Secretary") seeking to have certain portions of the 1987 amendments to the Higher Education Act of 1965

("the Act") declared unconstitutional and to enjoin the Secretary from withholding payments to them in accordance with the amendments. In the South Carolina and Maryland cases, the district courts declared that the statutory provisions in question violated the Fifth Amendment's prohibition against the taking of private property without just compensation. The North Carolina court, however, upheld the statute's constitutionality. Finding that the amendments do not effect an unconstitutional taking, we reverse the South Carolina and Maryland judgements and remand for further proceedings. We affirm the judgment in the North Carolina case.

I.

A. Statutory Background —

The Act established the Guaranteed Student Loan Program ("GSLP") to assist post-secondary school students. Under the GSLP, private lenders make low-interest loans, subsidized by the federal government, to students. The lenders are insured by various state guaranty agencies that 100% of the unpaid principal of qualifying loans will be paid in case of default. Each state wishing to enable students to participate in the program must either establish its own guaranty agency or designate a private, non-profit agency to serve as such. This agency, in turn, must enter into written agreements with the Secretary by which it agrees to operate the program under GSLP guidelines. The Secretary is also authorized to enter into reinsurance agreements with the guaranty agencies by which the Secretary promises to reimburse between 80%-100% (depending on the agency's default rate) of the amounts expended by the guaranty agency in repaying the unpaid principal remaining on defaulted loans.

In addition to the reinsurance payments, the Secretary is authorized to make advances to enable a new agency to commence operation and administrative cost allowances to offset an agency's operating costs. Subject to statutory restrictions, a guaranty agency is also authorized to receive the following types of payments: (1) a single insurance premium on each loan (not to exceed 3% of the loan)

which is paid by the lender and passed on to the student borrower; (2) a set portion of any amounts collected on defaulted loans for which the agency has received a reimbursement from the Secretary; (3) state appropriations; (4) gifts, grants and similar sources; and (5) investment earnings. Each guaranty agency is required to deposit these funds in a "reserve fund." 34 C.F.R. § 682.410(a)(1). The reserve fund may only be used for those GSLP purposes specified by the Secretary, such as paying claims from lenders and administering the program, 34 C.F.R. § 682.410(a)(2-6).

In response to concerns that these reserve funds had grown unnecessarily large, Congress enacted section 3001 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-36 (the "1987 Amendments"). These amendments required the Secretary to determine, using a statutory formula, the maximum allowable cash reserve for each guaranty agency. 20 U.S.C. § 1072(e)(2). The Secretary was also required to direct any state agency with an excess to transfer such amount to the Secretary. 20 U.S.C. § 1072(e)(2)(A)-(D). Any amounts recovered from the excess reserves were to be deposited into a student loan insurance fund which is used by the Secretary to make reimbursement payments under the GSLP. 20 U.S.C. § 1081(a). The Secretary is also authorized to waive repayment of any excess for certain specified reasons. 20 U.S.C. § 1072(e)(3).

B. The Instant Dispute

1. The guaranty agency in South Carolina is the South Carolina State Education Assistance Authority ("Authority"). This non-profit agency was created by statute in 1976 to administer the GSLP. Under the excess reserve formula, the Secretary established a cash reserve ceiling of $500,000 and required the Authority to transfer the excess ($2,739,528). The Secretary denied the Authority's request for a waiver of this transfer requirement. When the Authority refused to transfer any of the excess amount, the Secretary began

withholding reinsurance payments otherwise payable and applying these withheld amounts toward the $2.7 million due.

In October 1988, the Authority filed an action against the Secretary challenging the constitutionality of the excess reserve and related enforcement provisions of the 1987 amendments. The Authority also challenged both the Secretary's computation of the excess amount under the statutory formula and his denial of its request for a waiver. On May 31, 1989, the district court declared that the statutory provisions authorizing the withholding of reimbursements violated the Fifth Amendment's Takings Clause because the Authority had acquired "vested property rights" in such payments. Accordingly, the court enjoined any further withholding of reimbursement payments and ordered the Secretary to release any amounts withheld. ***S.C. State Educ. Assistance Authority v. Cavazos***, 716 F.Supp. 886 (D.S.C. 1989). The Secretary appeals from this order.

2. The guaranty agency in Maryland is the Maryland Higher Education Loan Corporation ("MHELC"), a non-profit corporation established by statute in 1963. MHELC entered into GSLP agreements with the Secretary in 1965. Under the statutory formula, the Secretary determined that MHELC was required to transfer $10,797,400 of its reserve fund. The Secretary denied MHELC's waiver request, and the guaranty agency subsequently refused to voluntarily transfer the excess amounts of its reserve fund. After the Secretary began to withhold reimbursement payments, MHELC filed suit for declaratory and injunctive relief. Unlike the Authority, however, MHELC did not challenge the Secretary's computation of its excess, nor did it challenge the denial of a waiver. The district court adopted the reasoning of the South Carolina court and granted the relief sought by MHELC. ***Md. Higher Educ. Loan Corp. v. U.S. Dept. of Educ.***, Civ. No. S 89-270 (D. Md. June 12, 1989). The Secretary's appeal followed.

3. The North Carolina State Education Assistance Authority ("NCSEAA") was created by the state in 1965 to administer a higher education loan program. In 1966, NCSEAA entered into the first of several agreements with the Secretary by which North Carolina agreed to participate in the GSLP. In 1988, the Secretary informed NCSEAA that it had an excess reserve of $15,911,946. Upon partial approval of NCSEAA's request for a waiver, this amount was reduced to $2,632,785. NCSEAA refused to transfer any of its excess to the Secretary and, as in the Maryland and South Carolina situations, the Secretary began to withhold reimbursement payments otherwise payable under the GSLP.

NCSEAA filed an action in district court challenging, ***inter alia***, the constitutionality of the 1987 Amendments' excess reserve provisions. On July 20, 1989, the district court upheld the constitutionality of the excess reserve amendments on the ground that the funds in question are public, rather than private, property and, as such, were not within the ambit of the Fifth Amendment's Takings Clause. Accordingly, the Secretary's motion for summary judgment was granted. ***State of N.C. v. United States,*** 725 F.Supp. 874 (E.D.N.C. 1989). NCSEAA appeals from this ruling.

II.

In each contract with the Secretary, the executory state agency agreed "to be bound by all changes in the Act or regulations in accordance with their effective dates." The regulations include a similar requirement. 34 C.F.R. § 682.400(d). The South Carolina court cites ***The Sinking Fund Cases***, 99 U.S. (9 Otto) 700 (1879), and ***Bowen v. Agencies Opposed to Soc. Sec. Entrapment***, 477 U.S. 41 (1986), for the proposition that only an **express statutory** reservation in an act of the power to amend is effective to permit subsequent legislative alteration of agreements entered into by the federal government in conformity with such act. We do not read these cases so restrictively. In ***Bowen***, although the power to amend was

reserved in the authorizing legislation under which the agreements at issue were executed, the Court focused on the notice such express reservation provided to the state that the statute could be amended in the future. ***Id.*** at 53. Moreover, the Court in ***Bowen*** noted that the power to amend is deemed to have been reserved unless it is expressly relinquished. ***Id.*** at 52. As the Court noted, "contractual arrangements, including those to which a sovereign itself is party, 'remain subject to subsequent legislation' by the sovereign." **Id.** ***(quoting Merrion v. Jicarilla Apache Tribe,*** 455 U.S. 130, 147 (1982)). Accordingly, we find no merit in the agencies' arguments that this power to amend was not reserved. ***See also Great Lakes Higher Educ. Corp. v. Cavazos,*** 711 F.Supp. 485, 494-96 (W.D. Wis. 1989); ***State of Del. v. Cavazos,*** 723 F.Supp. 234, 241-42 (D. Del. 1989). We turn, then, to the agencies' contentions that they had "vested property rights" which even a properly reserved power to amend could not reach.

III.

The constitutional provision at the core of these disputes is the Takings Clause of the Fifth Amendment: "[N]or shall private property be taken for public use, without just compensation." Simply stated, the state agencies contend that the transfer requirement of 20 U.S.C. § 1072(e)(2) contravenes this constitutional provision because the agencies' reserve funds constitute "private property" accrued pursuant to contracts with the Secretary. We agree with the Secretary and the North Carolina district court, however, that the excess reserve funds are not "private property" within the meaning of the Takings Clause.

The essential aspects of private property are "free use, enjoyment and disposal," ***Buchanan v. Warley,*** 245 U.S. 60, 74 (1917), and the "right to exclude others," ***Ruckelshaus v. Monsanto Co.,*** 467 U.S. 986, 1011 (1984). As explained in ***Ruckelshaus,*** such property interests "'are created and their dimensions are defined by existing rules or understandings that stem from an independent source

such as state law' [citations omitted]." *Id.* at 1001. The nature of the loan program militates against a finding that the state agencies possessed such indicia of private ownership. As the North Carolina district court stated, "[i]f property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, then it loses its character as 'private' property and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment." ***State of N.C. v. United States***, 725 F. Supp. at 876-77 (E.D.N.C. 1989). We agree that the regulations which completely control the reserve funds' uses are the sort of "existing rules or understandings" which prevent any of the guaranty agencies from acquiring an ownership interest in its reserve fund which would entitle it to protection as private property under the Takings Clause.

IV.

An alternative argument raised by the state agencies focuses not on the reserve fund itself as the property allegedly being taken but, rather, on the enforcement mechanism of the 1987 amendments which the state agencies claim acts to take their "vested contractual rights" to receive reimbursement payments. The South Carolina district court held that even if the power to amend had been effectively reserved, the contractual right to reimbursement payments had already vested in the Authority with regard to default payments already made. 716 F. Supp. at 794. The court's analysis proceeds from the principle that contractual rights are generally recognized to be property for purposes of the Takings Clause. ***See, e.g.,, Lynch v. United States***, 292 U.S. 571, 579-80 (1934). ***Citing The Sinking Fund Cases***, 99 U.S. at 719-21, the South Carolina court recognized that there exist some limits on the federal government's power to unilaterally amend its contracts and concluded that the 1987 Amendments had exceeded such limits. For a number of reasons, however, we believe that the state agencies' "contractual rights" to reimbursement payments had not "vested" so as to trigger Fifth Amendment protections.

The analysis of the vested/non-vested nature of the right to reimbursements is intertwined with the earlier discussion of the nature of the reserve funds themselves. The reserve funds are generated solely within the framework of a federal social welfare program involving students and prospective students throughout the nation. Just as the complete federal control over the use of the fund compels the conclusion that the targeted funds do not constitute private property for Fifth Amendment purposes, the contractual right to reimbursement payments destined for inclusion in such reserve funds similarly is not the type of property subject to the "takings" prohibition. The reservation of the power to amend the terms of the GSL program prevents the participating state agencies from invoking the Fifth Amendment Takings bar against subsequent Congressional action. *Great Lakes Higher Educ. Corp*, 711 F. Supp. at 495-96. The Court in *Bowen* emphasized that the sovereign authority to alter its contracts by subsequent legislation should not, if possible, be foreclosed and especially so in the context of a "comprehensive social welfare program." 477 U.S. at 52-53. We conclude that the public nature of the reserve funds themselves, coupled with the express contractual reservation of the power to amend the terms of the GSL program and the fact that the legislative changes involve a comprehensive federal/state social welfare program, forecloses a finding that the state agencies have obtained unalterable vested property rights to certain payments.+

V.

For the foregoing reasons, the judgments in the South Carolina and Maryland cases are reversed and these cases are remanded for further proceedings consistent with this opinion. The judgment in the North Carolina case is affirmed.

Nos. 89-2975/76-78 - REVERSED AND REMANDED
No. 89-2982 - AFFIRMED

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA

Case Number: 88-961-CIV-5

THE STATE OF NORTH CAROLINA, AND THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY

V.

THE UNITED STATES OF AMERICA; LAURO F. CAVAZOS, SECRETARY OF THE UNITED STATES DEPT. OF EDUCATION; AND THE UNITED STATES DEPT. OF EDUCATION

JUDGMENT IN A CIVIL CASE

____ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

_x_ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGE
that the defendants' motion for summary judgment is allowed.

THIS JUDGEMENT WAS FILED AND ENTERED THIS DATE, JULY 20, 1989, AND COPIES MAILED TO THE FOLLOWING:

Thomas J. Ziko
N.C. Dept. of Justice
P.O. Box 629
Raleigh, NC 27602

R. A. Renfer, Jr.
Asst. U.S. Attorney
P.O. Box 26897
Raleigh, NC 27611

Neil Koslowe
Civil Division, Rm. 3644
U.S. Dept. of Justice
10th St. & Penn. Ave., N.W.
Washington, D.C. 20530

July 20, 1989
/s/ J. Rich Leonard
Clerk

APPENDIX C

IN THE
UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

No. 88-961-CIV-5

THE STATE OF NORTH CAROLINA, and THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY,
Plaintiffs,

V.

THE UNITED STATES OF AMERICA; LAURO F. CAVAZOS, SECRETARY OF THE UNITED STATES DEPARTMENT OF EDUCATION; and THE UNITED STATES DEPARTMENT OF EDUCATION,
Defendants.

ORDER AND MEMORANDUM OPINION

On December 22, 1987, the Omnibus Budget Reconciliation Act of 1987 was enacted. Section 3001 (the "1987 Amendments") thereof provides for the recovery of excess cash reserves accumulated under the Guaranteed Student Loan Program. In effect, this produces a congressionally ordered ceiling on the amount of "excess cash reserves" that a state student loan guaranty agency may maintain. Reserves in excess of the cap are subject to recovery by the Secretary of Education or, failing in this remedy, the Secretary is

entitled to credit these reserves against current obligations to a state agency.

The 1987 Amendments give rise to the conflict between the parties in this suit and to this litigation.

FACTUAL BACKGROUND

This is an action for injunctive and declaratory relief brought by the State and its Education Assistance Authority against the United States in the person of the Secretary of Education.[1]

The State first sought to enjoin the implementation of this Act and, upon the Secretary's successful attribution of a credit for the excess reimbursements that are in controversy in this case, the State

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1 The North Carolina Education Assistance Authority "NCSEAA" is a political subdivision of the State of North Carolina. The North Carolina General Assembly created the NCSEAA in 1965 to administer a system of financial assistance for qualified students to enable them to obtain an education beyond the high school level. To fulfill that mandate the NCSEAA developed the North Carolina Insured Student Loan Program "NCISLP".

seeks declaratory judgment that the Secretary may not make such credit either under the Constitution or laws of the United States.

North Carolina's participation in financial assistance for college students had its beginning in 1965 with the creation of an Education Assistance Authority (NCSEAA) to implement an insured student loan program[2]

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2 In August 1966 the NCSEAA and the Secretary entered into the first of several agreements for the purpose of extending the benefits of the NCISLP and the Guaranteed Student Loan Program (the Federal program started in 1965) to qualified students. Under the 1966 Agreement the Secretary agreed to pay to the holder of loans insured by the NCSEAA the portion of the interest charges on such loans which students were entitled to have paid under the Higher Education Act.

In 1969 the parties entered into an agreement (entitled "Agreement for Federal Reinsurance of Loans Pursuant to 428(c) of the Higher Education Act of 1965"), under which the Secretary agreed to reimburse the NCSEAA eighty percent of the money the NCSEAA expended to discharge its insurance obligations under the NCISLP. In June 1977, the parties executed another agreement adding to the provisions discussed above an obligation on the part of the Secretary to make administrative cost allowance (ACA) payments to the NCSEAA.

By 1966 the State had appropriated $25,000 as a reserve trust for the insurance program. Over the course of the ensuing years the fund has grown by its accumulation of proceeds from insurance premiums, interest, and further appropriations from the State.

The NCSEAA has routinely entered into agreements with the Secretary defining the Secretary's participation in the program and allocating the risks of loss upon default by student borrowers ultimately giving rise to payment either from the trust fund, the federal government through the Secretary's obligation, or from the State.

Critical to an understanding of these agreements, and therefore to an understanding of the issues involved in this case, is a provision through which the parties have expressly conditioned the

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Footnote 2 continued:

In August 1977, the parties entered another agreement, the supplemental Guaranty Agreement, under which the Secretary has agreed to reimburse the NCSEAA 100% of the amount expended by the NCSEAA in discharge of its insurance obligations under the NCISLP for losses resulting from the default of student borrowers on the unpaid balance of the principal and accrued interest of any student loan insured under the NCISLP, provided the amount reimbursed by the Secretary does not exceed five percent (5%) of the loans which are insured by the NCSEAA in repayment at the end of the preceding fiscal year. If the reimbursement payments made by the Secretary under the agreement exceed five percent (5%) of the loans which areinsured under the NCISLP in repayment at the end of the preceding fiscal year, the Secretary is obligated to reimburse the NCSEAA for only ninety percent (90%) of the amount of such excess default. If the reimbursement payments made by the Secretary under the Supplemental Guaranty Agreement exceed nine percent (9%) of the loans which are insured under the NCISLP and which are in repayment at the end of the preceding fiscal year, the Secretary is obligated to reimburse the NCSEAA only eighty (80%) of the amount of excess defaults.

agreements on future changes made by Congress through legislation in the law governing the student loan program. The 1987 Amendments, at issue here, are just such legislation.

The 1987 Amendments require the Secretary to use certain formulas to determine the "maximum cash reserves" permitted each guaranty agency as of September 1986. Once the Secretary has determined the maximum cash reserve for each agency the statute requires the Secretary to direct the guaranty agencies to eliminate a total of $250 million of the "excess cash reserves" during the 1988-89 fiscal year. Under 20 U.S.C. § 1072(e)(2) the Secretary must direct an agency whose cash reserves exceed the ceiling to "eliminate" the excess by: (1) repaying advance payments that are not otherwise due; (2) withholding and canceling reimbursement claims that are otherwise payable; (3) reducing the amount to be claimed for administrative costs; (4) paying an additional reinsurance fee; or (5) adopting any other acceptable method of reducing payments from or increasing payments to the federal government. The recovered amounts are deposited in the student loan insurance fund established by 20 U.S.C. § 1081(a) and are used exclusively for GSLP purposes.

The Secretary has ordered NCSEAA to reduce its Reserve Trust Fund by $2,632,785.00.[3]

On October 20, 1988, the Secretary informed the NCSEAA that he would withhold reimbursement payments due the NCSEAA under the Supplemental Guaranty Agreement until the Department of Education had recovered $2,632,785.00 from the NCSEAA.

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[3] The Secretary originally requested a transfer of $15,911,946.00, but the plaintiffs objected and for reasons that are not relevant to the resolution of this case, the Secretary reduced the amount to $2,632,785.00.

DISCUSSION

In the plaintiffs' First, Second, Third and Fourth Claims for Relief they assert that the 1987 Amendments direct the defendants to take and that the defendants are taking the plaintiffs' property in violation of the plaintiffs' rights under the Fifth Amendment.

In order for the State to advance a claim that its property has been taken, the State must establish that the property in question is its "private property," and not property over which the United States has dominion and control. If property comes within the control of the United States to such an extent that its use is ultimately under the direction of the United States, then it loses its character as "private property" and becomes public to such an extent that it is not subject to a takings prohibition under the Fifth Amendment.

For Fifth Amendment purposes, "private property" is property as to which the claimant has the rights of "free use, enjoyment, and disposal," *Buchanan v. Warley*, 245 U.S. 60, 74 (1917), and the "right to exclude others." *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984). These rights "'are created and the dimensions are defined by existing rules or understandings that stem from an independent sources,'" such as federal and state laws and regulations. *Id.* at 1001.

The "existing rules or understandings" involved in this action are the statutes and regulations of the GSLP. An analysis of these "rules or understandings" demonstrate that NCSEAA has none of the essential "private property" rights over the money in its Reserve Trust Fund, including the excess cash reserves. Although NCSEAA was initially established under North Carolina law to administer North Carolina's student loan insurance program, once NCSEAA executed its GSLP agreements with the Department of Education and agreed to abide by the Higher Education Act and its regulations, its necessarily relinquished any "ownership" claim to funds it thereafter would be permitted to receive and retain for GSLP purposes. In return, NCSEAA became eligible for substantial federal benefits. As the

defendants correctly point out, it is only because NCSEAA joined the GSLP that interest payments by students on the loans it guarantees are federally subsidized; that its guarantees are reinsured by the Secretary; and that it receives considerable federal payments, including reimbursements of between 80% and 100% on claims payments to lenders, administrative cost allowances, and 30% of collections on defaulted loans on which the Secretary has already made a reinsurance payment.

An examination of the GSLP statutes and regulations show that NCSEAA does not have the rights of "free use, enjoyment, and disposal" of its reserve fund, or the right to "exclude others" (that is, the Secretary) from it. As of the end of fiscal year 1986, when the Secretary determined the amount of excess cash reserves NCSEAA was required to eliminate, NCSEAA had received funds from at least seven sources: (1) insurance premiums collected from lenders; (2) state appropriations; (3) federal reinsurance payments; (4) federal administrative cost allowances; (5) collections on defaulted loans; (6) investment earnings; and (7) other non-federal sources. NCSEAA's ability to collect insurance premiums from lenders is authorized and limited by 20 U.S.C. § 1078(b)(1)(H); its ability to receive federal reinsurance payments is authorized and limited by 20 U.S.C. § 1078(c)(1); its ability to receive federal administrative cost allowances is authorized and limited by 20 U.S.C. 1078(f); its ability to collect and retain a portion of defaulted loans for which it has been reimbursed is authorize and limited by 20 U.S.C. § 1078(c)(2)(D), (c)(6); and its ability to derive earnings by investing its reserves is authorized and limited by 20 U.S.C. § 1072(b)(3) and 34 C.F.R. 682.410(a)(1)(ix), (a)(3), (a)(4)(i), (a)(5), (a)(6).

Also, under 34 C.F.R. 682.410(a), NCSEAA is prohibited from using any of the money in its reserve fund for purposes other than the GSLP purposes specified by the Secretary. It may use these assets only to guaranty loans; pay default claims; pay death, disability, and bankruptcy claims; refund overpayments of insurance premiums; pay to the Secretary his share of collections on defaulted

loans; repay federal advances; and administer its loan program. 34 C.F.R. 682.410(a)(2).

The statutes and regulations above show that the federal government has control over most of the sources and all of the uses of NCSEAA's Reserve Trust Fund. In light of these facts, the court finds that the excess cash reserves which are the subject of this action are not "private property," but public property, and as such are not entitled to Fifth Amendment protection. This court is in agreement with the United States District Court, District of South Dakota which recently held: "the right of Congress to alter the GSL program prevents [the guaranty agency] from possessing a property right within the meaning of the Fifth Amendment to the portion of the reserve fund claimed by the [1987 Amendments]." *Education Assistance Corp. v. Cavazos.*, No. 88-1054, Slip. op. at 24 (D.S.D., July 14, 1989). Having concluded that the money at issue in this case is not "private property," the court need not discuss whether a "taking" occurred in this case.

The court does not find any merit in any of the other arguments cited by the plaintiffs in support of their motion for summary judgment. Accordingly, the plaintiffs' motion for summary judgment is DENIED and the defendants' motion for summary judgment is ALLOWED.

/s/
TERRENCE W. BOYLE
UNITED STATES DISTRICT JUDGE

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 89-2975

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiff - Appellee

V.

LAURO F. CAVAZOS, etc., et al., in his official capacity as Secretary, United States Department of Education; U.S. DEPARTMENT OF EDUCATION;
Defendants - Appellants

NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS, INC.; VIRGINIA STATE EDUCATION ASSISTANCE AUTHORITY
Amici Curiae

No. 89-2976

MARYLAND HIGHER EDUCATION LOAN CORPORATION, a nonprofitMaryland Corporation
Plaintiff - Appellee

V.

LAURO F. CAVAZOS, Secretary of the United States Department of Education
Defendant - Appellant

No. 89-2978

SOUTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiff - Appellee

V.

LAURO F. CAVAZOS, Secretary of Education; U.S. DEPARTMENTOF EDUCATION
Defendants - Appellants

No. 89-2982

STATE OF NORTH CAROLINA; THE NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY
Plaintiffs - Appellants

V.

UNITED STATES OF AMERICA; LAURO F. CAVAZOS, Secretary of the United States Department of Education; U.S. DEPARTMENT OF EDUCATION
Defendants - Appellees

ON PETITIONS FOR REHEARING WITH SUGGESTIONS FOR REHEARING IN BANC

The appellees South Carolina State Education Assistance Authority and Maryland Higher Education Loan Corporation and appellants State of North Carolina and North Carolina Education Assistance Authority's petitions for rehearing and suggestions for

rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestions for rehearing in banc, and

As the panel considered the petitions for rehearing and is of the opinion that they should be denied,

IT IS ORDERED that the petitions for rehearing and suggestions for rehearing in banc are denied.

Entered at the direction of Judge Hall with the concurrence of Judge Russell and Judge Widener.

For the Court,
/s/
John M. Greacen, Clerk

Stamped "Filed MAR 28, 1990
U.S. Court of Appeals Fourth Circuit"

APPENDIX E

PUB. L. NO. 100-203, 101 STAT. 1330-36 SEC. 3001 RECOVERY OF EXCESS CASH RESERVES ACCUMULATED UNDER THE GUARANTEED STUDENT LOAN PROGRAM

(a) IN GENERAL--Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is amended by adding at the end thereof the following new subsection:

(e) REDUCTION OF EXCESS CASH RESERVES.--

(1) LIMITATION ON MAXIMUM CASH RESERVES--A guaranty agency shall not accumulate cash reserves in excess of the greater of--

"(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;

"(B) 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;

"(C) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount

"(D) $500,000; or

"(E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

"(2) RECOVERY OF EXCESS CASH RESERVES.--The Secretary shall, not later than March 31, 1988, determine for each guaranty agency the maximum cash reserve permitted under paragraph (1) for fiscal year 1986. Subject to paragraphs (3) and (4), if the Secretary determines that any guaranty agency had, at the end of fiscal year 1986, a cash reserve that exceeded such maximum, the Secretary shall direct the agency to eliminate such excess by any one or more of the following methods, as selected by the guaranty agency:

"(A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d);

"(B) by withholding and canceling claims for reimbursement otherwise payable under section 428(c)(1);

"(C) by reducing the amount of payments for which application will be made by such agency under section 428(f); or

"(D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees in addition to the fees required by section 428(c)(9), as proposed by the agency and agreed to by the Secretary.

"(3) APPEALS BASED ON SPECIAL CIRCUMSTANCES.--(A) If the Secretary determines, on the basis of an application from a guaranty agency, that--

"(i) the agency's financial position has deteriorated significantly since the end of the preceding fiscal year;

"(ii) significant changes in the economic circumstances (such as a change in agency current cash reserves) or the loan insurance program render the limitations of paragraph (1) inadequate for the continued functioning of the agency; or

"(iii) in recovering funds as required by this subsection, a guaranty agency would be compelled to violate contractual obligations existing on the date of enactment of this subsection that require a specified level of reserve funds to be maintained by such agency;

the Secretary may waive, in whole or in part, the imposition of the remedies required by paragraph (2) for such agency.

"(B) The Secretary shall respond to request for waivers from guaranty agencies in an expedited manner and, except for unusual circumstances or with the consent of the guaranty agency, shall resolve such request within 6 weeks of submission.

"(4) RECOVERY LIMITS.–The Secretary shall not require a total reduction of cash reserves for all guaranty agencies in excess of $250,000,000 during fiscal year 1988. If the total of cash reserves of all guaranty agencies exceeds the maximum amounts permitted under paragraph (1) by more than $250,000,000 the Secretary shall ratably reduce the

amounts that guaranty agencies are directed to eliminate under paragraph (2), so that the total excess cash reserves to be eliminated equals $250,000,000.

"(5) DEFINITIONS.--As used in this subsection--

"(A) the 'cash reserves' for any guaranty agency for any fiscal year are equal to the agency's cumulative cash receipts less the agency's cumulative cash disbursements at the end of such fiscal year;

"(B) the 'total reserves' for any guaranty agency for any fiscal year are equal to the agency's cash reserves plus the agency's cumulative accounts receivable less the agency's accounts payable, as of the end of such fiscal year;

"(C) the term 'cumulative cash receipts' includes such receipts as insurance premiums, Federal reinsurance payments, and collections on defaulted loans;

"(D) the term 'cumulative cash disbursements' includes such disbursements as payments for default claims, repayment of Federal advances, transfers to other State activities, and payment of collection costs and other operating costs;

"(E) the term 'accounts receivable' includes Federal reinsurance payments and administrative cost allowances owed but not yet paid to the guaranty agency, as of the end of a fiscal year; and

"(F) the term 'accounts payable' includes collections and reinsurance fees due (but not paid) to the Department of Education, as of the end of a fiscal year.".

(b) CONFORMING AMENDMENTS.--

(1) The second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

(2) Section 428(c)(9)(A) of such Act is amended by striking out "an amount equal to" and inserting "an amount, subject to section 422(e), equal to".

(3) The second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

SEC. 3002. REPEAL

(a) IN GENERAL.--Subsection (e) of Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is repealed on September 30, 1989.

(b) CONFORMING AMENDMENTS.--

(1) Effective September 30, 1989, the second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall, subject to section 42(e), be deemed" and inserting "shall be deemed".

(2) Effective September 30, 1989, section 428(c)(9)(A) of such Act is amended by striking out "an amount, subject to section 422(e), equal to" and inserting "an amount equal to".

(3) Effective September 30, 1989, the second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

APPENDIX F

Section 428(c)(1)(A) of the Higher Education Act of 1965 [20 U.S.C. § 1078(c)(1)(A) (1988)]

(c) Guaranty agreements for reimbursing losses

(1) Authority to enter into agreements

(A) The Secretary may enter into a guaranty agreement with any guaranty agency, whereby the Secretary shall undertake to reimburse it, under such terms and conditions as the Secretary may establish, with respect to losses (resulting from the default of the student borrower) on the unpaid balance of the principal and accrued interest of any insured loan, including the administrative costs of supplemental preclaim assistance for default prevention as defined in paragraph (6)(C). The guaranty agency shall, *subject to section 1072(e) of this title*, be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement according to the provisions of this subsection. Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in paragraph (7), the amount to be paid a guaranty agency as reimbursement under this subsection shall be equal to 100 percent of the amount expended by it in discharge of its insurance obligation incurred under its loan insurance program. In no case shall a guaranty agency file a claim under this subsection for reimbursement with respect to losses prior to 270 days after the loan becomes delinquent with respect to any installment thereon. (*Emphasis added*).

[The emphasized phrase was inserted pursuant to § 3001(b) of the OMBR. (App. 30A). Otherwise the statute is identical to 20 U.S.C. § 1078(c)(1)(A) (Supp. IV 1986).]

APPENDIX G

34 C.F.R. § 682.410(a) (1988)

FISCAL, ADMINISTRATIVE AND ENFORCEMENT REQUIREMENTS

(a) Fiscal requirements. A guarantee agency shall establish, at a minimum, the following fiscal procedures:

(1) The guarantee agency shall establish and maintain a reserve fund to which the guarantee agency shall credit–

(i) Federal advances obtained under, and matching funds required by, section 422(a) of the Act;

(ii) Funds appropriated by a State for the agency's loan guarantee program;

(iii) Federal advances obtained under § 682.403;

(iv) Funds received by the guarantee agency as loan insurance premiums;

(v) Administrative cost allowances received by the guarantee agency under § 682.407;

(vi) Funds received by the guarantee agency for the agency's loan guarantee program from gift, grant, or other sources;

(vii) Funds collected on defaulted loans;

(viii) Death, disability, bankruptcy, and reinsurance payments received from the Secretary; and

(ix) Funds earned from investments under paragraph (a)(5) of this section.

(2)Except as provided in paragraphs (a)(3) and (a)(4) of this section, a guarantee agency may use the assets of the reserve fund established under paragraph (a)(1) of this section only to--

(i) Guarantee loans under the guarantee agency's loan guarantee program;

(ii) Pay default claims;

(iii) Pay death, disability, and bankruptcy claims;

(iv) Refund overpayments of insurance premiums;

(v) Pay to the Secretary the Secretary's equitable share of borrower payments; and

(vi) Repay advances made by the Secretary.

(3) Except as provided in paragraph (a)(4) of this section, a guarantee agency may also use loan insurance premiums, administrative cost allowances, interest or investment earnings, and funds described in paragraph (a)(1)(vi) of this section for payments necessary for the proper administration of the guarantee agency's loan guarantee program.

(4)(i) The guarantee agency may use the amount of Federal advances identified in paragraph (a)(1)(iii) of this section, and interest or other earnings on those advances, only to pay default claims.

(ii) The guarantee agency shall account separately for the funds described in paragraph (a)(4)(i) of this section.

(5) The guarantee agency may invest the assets of the reserve fund described in paragraph (a)(1) of this section only in low-risk securities,

such as obligations issued or guaranteed by the United States or a State, and shall exercise the level of care in that investment required of a fiduciary charged with the duty of investing the money of others.

(6) If the guarantee agency uses loan insurance premiums or funds earned from investments under paragraph (a)(5) of this section to buy an asset and--

(i) If the agency subsequently sells that asset, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the sale proceeds equal to the percentage of the original purchase price of the asset paid with the insurance premiums and investment earnings; or

(ii) If the agency subsequently converts the asset to a use unrelated to its GSLP or PLUS loan guarantee program, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the fair market value of the asset equal to the percentage of the original purchase price paid with the insurance premiums or investment earnings.

APPENDIX H

DEPARTMENT OF HEALTH, EDUCATION AND WELFARE
Office Of Education
Washington, D.C.

SUPPLEMENTAL GUARANTY AGREEMENT FOR FEDERAL RE-INSURANCE OF LOANS HIGHER EDUCATION ACT OF 1965, AS AMENDED

WHEREAS, North Carolina State Education Assistance Authority (hereinafter referred to as the "Agency"), has entered into an agreement with the United States Commissioner of Education (hereinafter referred to as the "Commissioner") pursuant to Section 428(b) of The Higher Education Act of 1965, as amended (hereinafter referred to as the "Act"), dated August 2, 1966 (hereinafter referred to as the "428(b) Agreement") entitling students who receive loans which are insured by the Agency to have made on their behalf the payments provided in Section 428(a) of the Act; and

WHEREAS, the Agency has entered into an Agreement with the Commissioner pursuant to Section 428(c)(1)(A) of the Act, dated August 1, 1969 (hereinafter referred to as the "428(c) Agreement"), providing for Federal reimbursement of a percentage of losses incurred by the Agency which result from the default of borrowers receiving student loans insured by the Agency; and

WHEREAS, the agency has entered into an Agreement with the Commissioner pursuant to Section 422 of the Act, dated July 27, 1966 (hereinafter referred to as the "422 Agreement") providing for advances by the Commissioner to help establish or strengthen the Agency's reserve fund; and

WHEREAS, the Agency assures the Commissioner of its intention to continue to carry out a program of loan insurance under the 422 Agreement, the 428(b) Agreement and the 428(c) Agreement, which Agreements are in full force and effect; and

WHEREAS, the Agency assures the Commissioner that, with respect to so much of any loan insured under the Agency's Student Loan Insurance Program as may be guaranteed by the Commissioner pursuant to this Agreement and to Section 428 A of the Act, the undertaking of the Commissioner under this Agreement is acceptable in full satisfaction of the laws and regulations of the State of North Carolina regarding the maintenance of the Agency's reserve funds; and

WHEREAS, the Agency assures the Commissioner that its Student Loan Insurance Program meets, and will continue to meet, the requirements of Section 428A(a)(1) of the Act; and
WHEREAS, the Agency assures the Commissioner that it is and will continue to be, otherwise in compliance with the Act and any regulations promulgated pursuant to the Act;

NOW, THEREFORE, pursuant to the provisions of Section 428A of the Act, it is hereby agreed by and between the parties as follows:

1. Based on the above set forth assurances, the Commissioner determines that the Agency is eligible to enter into this Supplemental Guaranty Agreement.

2. The Commissioner shall reimburse the Agency, at such times, in such manner, and on the basis of such documentation as he may from time to time reasonably prescribe, with respect to losses (resulting from the default of student borrowers or, in the case of loans made prior to December 15, 1968, resulting from the death or total and permanent disability of student

borrowers) on the unpaid balance of the principal and accrued interest of any student loan insured under the Agency's Student Loan Insurance Program in an amount equal to one hundred per centum (100%) of the amount expended by the Agency in the discharge of its insurance obligations incurred under its Student Loan Insurance Program, except that:

(a) if, for any Federal fiscal year, the amount of such reimbursement payments by the Commissioner pursuant to this Agreement exceed five per centum (5%) of the loans which are insured by the Agency under its Student Loan Insurance Program and which were in repayment at the end of the preceding fiscal year, the amount to be paid as reimbursement under this Agreement for such excess shall be equal to ninety per centum (90%) of the amount of such excess; and

(b) if, for any Federal fiscal year the amount of such reimbursement payments exceeds nine per centum (9%) of such loans, the amount to be paid as reimbursement under this Agreement for such excess shall be equal to eighty per centum (80%) of the amount of such excess.

For purposes of this Agreement, the amount of loans of the Agency which are in repayment shall be the original principal amount of loans insured by it reduced by (i) the amount the Agency has been required to pay to discharge its insurance obligations under the Act, (ii) the original principal amount of loans insured by it which have been fully repaid, (iii) the original principal amount insured on those loans

for which payment of the first installment of principal has not become due pursuant to Section 428(b)(1)(E) of the Act or such first installment need not be paid pursuant to Section 428(b)(1)(M) of the Act and (iv) the original principal amount of loans repaid by the Commissioner under Section 437 of the Act.

3. All payments made by the Commissioner to the agency pursuant to this agreement will be promptly deposited in or credited to the agency's reserve fund, or if applicable, the reserve fund maintained for the purposes of Section 422(c) of the Act.

4. The Agency shall establish and maintain such administrative and fiscal procedures as are necessary to assure proper and efficient administration of its Student Loan Insurance Program and the Agency shall assure that due diligence (as described in regulations promulgated by the Commissioner, unless the Agency has established and disseminated its own specific standards for due diligence) will be exercised by lenders in the making, servicing, and collecting of loans insured under its Student Loan Insurance Program and by the Agency in the collecting of defaulted loans which it holds. The Commissioner's execution of this Agreement shall not be construed as indicating his acceptance of any procedures as may currently be or previously have been employed by the Agency.

5. In connection with any claim for payment on a loan re-insured pursuant to this Agreement, the Agency shall assure the Commissioner that (a) the terms of such loan comply with all Agency, state and Federal requirements, (b) that all reasonable efforts have been made to collect the loan, and (c) the loan is in default

or, with respect to loans made prior to December 15, 1968, that the borrower is deceased or is totally and permanently disabled (as defined and determined in the Act an the regulations promulgated thereunder).

6. The agency shall submit reports to the Commissioner at such times and in such manner as he may reasonably prescribe concerning the status of the reserve fund and the operation of the Agency's Student Loan Insurance Program. The Agency shall keep such records as may be necessary to make such reports, and shall afford access thereto at any reasonable time to the Commissioner or other agencies of the Federal government designated by the Commissioner to assure the correctness and verification of such reports.

   In addition the Agency shall submit to the Commissioner upon request any of the forms, procedures or other materials used in the operation of its Student Loan Insurance Program. The Agency shall also submit to the Commissioner for his approval and prior to their adoption any forms, procedures, regulations, or other materials which the Agency proposes to adopt or revise and which substantially affect the operation of its Student Loan Insurance Program, including any proposed arrangement with a private non-profit loan insurance agency for the administration of the Agency's Student Loan Insurance Program.

7. If, after a payment has been made by the Commissioner pursuant to this Agreement with respect to any loan, any payments are made to the Agency in discharge of the obligations incurred by the borrower with respect to such loan (including any payments of interest accruing on any such loan after such payment by the Commissioner), there shall be paid over to the

Commissioner (for deposit in the fund established by Section 431 of the Act) such portion of the amount of such payment as is determined (in accordance with regulations prescribed or to be prescribed by the Commissioner) to represent his equitable share thereof, but otherwise, there shall be no subrogation of the United States to the rights of the Agency; provided, that except as the Commissioner may otherwise by or pursuant to regulation provide, amounts so paid by a borrower on such loan shall be first applied in reduction of principal owing on such loan. The Agency shall submit payments due the Commissioner pursuant to this section within 60 days of the receipt of such payments. The Commissioner may set off the amounts payable to him by the Agency against amounts payable by him to the Agency.

8. The Agency may, if authorized by regulations promulgated under the Act, allow forbearance for the benefit of the student borrower as may be agreed upon by the parties to the loan and approved by the Agency.

9. The Commissioner's obligation to make payments, as provided for in this Agreement, shall extend only with respect to loans insured by the Agency prior to the expiration of the authority provided in the Act. This Agreement is subject to annual renegotiations; provided, however, that until 60 days (or such longer period as the Commissioner may permit) after the Commissioner commences such renegotiation, this Agreement shall remain in effect so as to provide Federal re-insurance benefits to the greatest extent possible under the Act as to all student loans guaranteed by the Agency.

10. This Agreement may be terminated by either party upon not less than 60 days written notice to the other party, except that the Commissioner may terminate this Agreement only for cause. Termination shall not affect obligations incurred under this Agreement by either party before the effective date of termination. If termination is effected by the Commissioner, it will not become final until the Agency has been afforded reasonable notice and an opportunity for a hearing, except that the Commissioner may suspend this Agreement pending the outcome of the hearing if he determines that such action is necessary in order to prevent substantial harm to Federal interests.

    If the Commissioner finds that any of the assurances or representations made by the Agency in connection with this Agreement are incomplete or incorrect in any material respect or that there has been a failure by the Agency to comply with any of the provisions of this Agreement or applicable Federal law or regulations, he may take such action short of termination as may be necessary to protect the interests of the United States. Such action may include withholding payments to be made to the Agency (or to lenders whose loans are insured by the Agency) until adequate documentation therefor is provided or requiring that the Agency reimburse the Commissioner for any payments made, or any payments which the Commissioner has become obligated to make, as a result of the Agency's making such incomplete or incorrect statements or violating such provisions of this Agreement or applicable Federal law or regulations.

11. This Agreement shall be construed in the light of the Act and the regulations thereunder.

12. No member of or delegate to Congress, or resident Commissioner, shall be admitted to any share or part of this agreement, or to any benefit that may arise therefrom; but this provision shall not be construed to extend to this agreement if made with a corporation for its general benefit.

13. This agreement shall apply to all reinsurance payments made by the Commissioner after November 1, 1976, which the parties agree is the date that the Agency implemented a program of student loan insurance meeting the requirements of Section 428(a)(1) of the Act.

North Carolina State Education Assistance Authority
Name of Agency

Dated: June 16, 1977

BY: Stan C. Broadway /s/
Executive Director

And Charles F. George, Jr./s/
Assistant Director

UNITED STATES COMMISSIONER
OF EDUCATION

Date: August 2, 1977

By: /s/
Acting Associate Commissioner
Title